1936

Examination [1936]

Virginia State Board of Accountancy

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VIRGINIA STATE BOARD OF ACCOUNTANCY

RICHMOND, VIRGINIA
November 19, 20 and 21
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PRICE, 25 CENTS PER COPY

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Examination
Virginia State Board of Accountancy

THEORY OF ACCOUNTS

NOVEMBER 19, 1936—9 A. M. TO 1 P. M.

Answer All Questions

Do not repeat questions, but designate them by numbers and letters

Question 1:

A 51% ownership in the common stock of a subsidiary was acquired in small amounts by its parent from the subsidiary's stockholders over a period of several years; the last purchase of approximately 5% on April 30, 1936, was sufficient for the parent to obtain its 51% control. In preparing a consolidated balance sheet reflecting the present ownership, how would you dispose of surplus of the subsidiary applicable to the various purchases in prior years, and how would you dispose of dividends now paid to the parent from such surplus?

Question 2:

A smelting company credits gross income with the current market values of metals recovered from the refining of ores. This credit is made upon the date recovery is completed. When sales of the refined ores are made the variation between the sales price and market at the date production was completed is credited or charged to an account known as "Reserve for Inventory Variation." At the company's balance-sheet date the reserve had a credit balance exceeding $4,000,000. One company official takes the position that the reserve is a valuation account and should be deducted on the balance sheet from the inventory. Another regards the reserve as a part of earned surplus. Another states that it is in the nature of a general reserve available for absorbing inventory and other losses in the future. What is the reserve in your opinion, and how would you classify it on the balance sheet?

Question 3:

(a) Do you regard stock dividends as income to the recipient? How should they be recorded in the recipient's accounts, if at all, if the stock dividend were paid (a) in the same class of stock (b) in a different class of stock? Disregard Federal income-tax interpretations unless you consider them appropriate.

(b) Distinguish between a split-up and a stock dividend.

Question 4:

(a) How would you determine the book value of a given class of capital stock?

(b) State your reasons for or against showing as a current asset the cash-surrender value of insurance policies on the lives of officers where the corporation is the beneficiary.

Question 5:

What recommendations would you offer a client who desires to have his records reflect the best accounting practices with respect to trade and cash discounts on purchases? His capital is sufficiently large to insure his taking advantage of all discounts.

Question 6:

In August, 1932, the Krakow Manufacturing Company had its plant appraised in connection with the floatation of a first-mortgage-bond issue. The balance sheet submitted by the auditors incorporated the appraised values, showing reproduction cost new less accrued depreciation. Appreciation surplus of $263,575.00 resulted from taking up the appraised value. Depreciation charged to operations in subsequent periods was based upon appraised values; profit or loss on the disposition of assets acquired prior to the appraisal was also based on appraised values. No change was made in the appraisal surplus, the amount remaining at $263,575.00 on December 31, 1935. What comments or criticisms have you to make on the procedure followed?

Question 7:

A newly organized corporation conducts an extensive advertising campaign through the mediums of newspapers, billboards and magazines. The management of the company believes that the current period should not stand the full cost of the advertising in view of the fact that the benefits in the way of future sales would not be received until later. Discuss the points involved and what you would consider to be the proper method of handling advertising expenditures. Would your answer be different if the company was a well-established concern and used its advertising campaigns to maintain its sales position?

Question 8:

In auditing the salesmen's accounts of the Raymond Sales Corporation you find the following conditions:

(a) Salesmen are given advances to pay traveling expenses. On the balance sheet date (June 30, 1931) these advances totalled $10,500.00. Each salesman prepared expense vouchers at June 30, 1931, which appeared in vouchers payable in the amount of $6,318.26.

(b) Certain salesmen are permitted to draw against their commissions. The excess of drawings over commissions credited to them was $26,351.12. In both cases, the salesmen in question are still in the employ of the company.

How should salesmen's accounts appear on the balance sheet of June 30, 1931?

Question 9:

Part of the inventory of the E Company at June 30, 1935, was also on hand at June 30, 1934. On the latter date the cost was reduced to market but during the year following the market price rose to a figure exceeding original cost. The company has restored original cost in the June 30, 1935, inventory. Give reasons for or against this procedure.

Question 10:

Company A leases a plant from Company B for a period of ten years. In order to equip this plant properly, Company A is forced to make major improvements to the buildings in the amount of $20,000.00 and to install machinery which cannot be moved at the expiration of the lease, costing $30,000.00, the plant to be turned back to Company B at the expiration of the lease.

(a) What rate of depreciation will Company A be entitled to take on the improvements made by it?

(b) After the expiration of five years it is decided to abandon the plant, inasmuch as it is unprofitable to operate. In that case what will Company A be entitled to write off as a loss?

(c) What depreciation, if any, will Company B be entitled to write off during the period of the lease?

(d) On what amount will Company B be entitled to take depreciation after the lease expires or has been abandoned by Company A with respect to the improvements made?

PRACTICAL ACCOUNTING

PART I

November 19, 1936—2 P. M. to 6 P. M.

Problem 1 (30 Points)

A statutory merger has been effected between Companies A, B, and C, and you have been asked to draft the journal entries for A as at October 31, 1936, in order to reflect the changes in the accounts made necessary by its acquisition of the net assets of Companies B and C and to prepare a balance sheet of Company A after giving effect to these entries. Changes in surplus, on the consolidated basis, should appear on the balance sheet.

At the date mentioned, the financial position of the companies was as follows:

Assets	*A*	*B*	*C*
Investment in A	------	$ 15,275.00	------
Investment in A's bonds	------	------	$ 10,740.00
Investment in B	$ 189,463.26	------	------
Investment in C	254,011.50	------	------
Intercompany accounts	84,795.33	------	60.72
Unamortized bond discount	6,300.00	------	------
Other assets	686,577.39	336,371.57	374,198.40
Total assets	$ 1,221,147.48	$351,646.57	$384,999.12
Liabilities			
Trade creditors	$ 241,546.93	$ 81,387.48	$ 63,273.43
Accrued interest on bonds	2,500.00	------	------
5% bonds outstanding	150,000.00	------	------
Intercompany accounts	346.52	25,366.81	59,142.72
Capital stock, par value $100	750,000.00	200,000.00	350,000.00
Earned surplus, or deficit*—			
Balance January 1, 1936	75,240.52	34,586.35	84,095.25*
Net profit, ten months	31,513.51	10,305.93	3,321.78*
Cash dividend, July 1	30,000.00*	------	------
Total liabilities	$ 1,221,147.48	$351,646.57	$384,999.12

The following particulars are given you:

(a) A's investment in B was acquired by cash payments to B's stockholders as at January 1, 1924, and consists of 90% of the capital stock of B Company; the surplus of B was then $30,357.18. Earnings since have been $62,535.10; and dividends paid, $48,000.00.

(b) A's investment in C is a 100% interest purchased as at January 1, 1934. The deficit of C on that date was $87,300.34; a net profit of $4,469.52 was earned in 1934 and a net loss of $1,264.43 was sustained in 1935.

(c) B's investment in A was purchased on the market in 1921 (the market on January 1, 1924, was $180 per share); it consists of 200 shares of A's 7,500 outstanding shares of capital stock, including a stock dividend of 100% paid by A on December 31, 1925, and is valued at original cash outlay. These shares will be cancelled and retired as at October 31.

(d) C's investment in A's bonds, 1939 series, consists of 10 $1,000 coupon bonds, purchased at market on January 1, 1936. Coincident with the merger, the bonds have been cancelled and cannot be reissued. A's bonds mature as follows:

Date of Maturity	*Amount*
June 30, 1937	$50,000.00
June 30, 1939	50,000.00
June 30, 1941	50,000.00

The bond discount has been prorated on the basis of prospective interest payable, but no amortization has been made as yet for the year 1936. No interest receivable has been accrued by C since the June 30 semi-annual coupon.

(e) The 200 minority shares of Company B are to be purchased for cash at book value as determined by you, B's investment in A remaining unchanged for the purpose of the purchase.

Consistently since the acquisition of its subsidiaries, Company A has presented consolidated financial statements to its stockholders.

PRACTICAL ACCOUNTING

PART I

Problem 2 (20 Points)

From the following balance sheet prepared from the books and sent you by the auditor of the City of Sharon, prepare a reconstructed and adjusted statement, following nomenclature, classification and other practices which you believe express the best principles of municipal accounting; and append to your statement a reconciliation of book (a) surplus at June 30, 1935, and (b) excess of revenues over expenditures for the year ended June 30, 1936, with the corresponding items as you have determined them.

CITY OF SHARON

BALANCE SHEET AT THE CLOSE OF BUSINESS, JUNE 30, 1936

Resources

Water plant, constructed as at June 30, 1916, with bond issue of $1,200,000 and current appropriations of $50,000; estimated life, then and now, 100 years—		
Original cost		$ 1,250,000.00
Additions as at June 30, 1924		266,800.00
Additions as at June 30, 1936		1,865.00
		$ 1,518,665.00
Less—4½% serial bonds ($20,000 payable semi-annually) in hands of public		400,000.00
City's equity in water plant		$ 1,118,665.00
Taxes receivable from past years, of which 25% is believed to be uncollectible, less tax-anticipation notes of $40,000.00, and estimated accrued interest of $12,843.02 to be paid thereon		13,414.16
Taxes levied for current year, of which it is hoped 90% will be collected—	*Total Extended*	
1st installment, past due	$103,586.20	22,832.55
2nd installment, due September 1	103,586.20	87,273.64
Special assessments—		
Past due, including interest of $6,347.50		34,803.91
Not due		23,327.63
Cash on deposit, including bond principal and interest of $29,000.00 due July 1, 1936		86,451.93
Tax liens (1934 and prior) worth about 70% of		15,279.25
Supplies on hand (cost)		3,480.42
Total resources		$ 1,405,528.49

Liabilities

Vouchers approved for payment by council on June 25, 1936		$ 37,425.27
Contracts due and payable out of this year's appropriations		33,376.22
Other bills due		5,644.14
Total amounts owing to outsiders at June 30, 1936		$ 76,445.63
Lapsed appropriations, net		1,782.05
Appropriations holding over to next year (ending June 30, 1937), including bond principal and interest due July 1, 1936		43,119.63
Budgeted excess of income over expense		2,142.36
Taxes belonging to next year, collected in advance		1,000.00
General reserve (for working capital), created in 1925		50,000.00
Income from special assessment net interest		50.02
Special assessment bonds unpaid, $5,000 past due	$ 55,000.00	
Interest accrued thereon	2,318.73	
	$ 57,318.73	
Less—Cash collected and held in bank for bondholders	4,372.40	52,946.33
Surplus of resources—balance July 1, 1935		1,178,042.47
Total liabilities		$ 1,405,528.49

PRACTICAL ACCOUNTING

PART II

NOVEMBER 20, 1936—9 A. M. TO 1 P. M.

PROBLEM 3 (15 POINTS)

A summary of entries in the inventory account of a department in a retail store for the month of October was as follows:

Inventory at retail 10-1-36 (163.93443% of cost, "cost" consisting of invoice cost, freight estimated at 5%, and an "overhead" loading charge of 7%)	$237,460.72	
Purchases, October, at invoice cost	87,576.17	
Freight	3,984.13	
Loading charge	6,130.33	
Markup on purchases	65,127.09	
Markdowns		$ 13,862.10
Cancellations of markdowns	5,783.42	
Net sales, October		122,562.18

You are called upon to compute the book inventory at cost at October 31. Cost is to be estimated invoice cost plus freight of 5%; cost of sales for the month is to be determined by subtracting from sales plus net markdowns, an average markup as at the end of the month computed on the basis of total merchandise handled; that is, without reference to sales or markdown adjustments made during the month.

PRACTICAL ACCOUNTING

PART II

PROBLEM 4 (35 POINTS)

As of January 1, 1936, companies X and Y enter into an agreement whereby X is to sell and Y is to buy the entire output of X, according to the following terms and conditions:

1. Contract is to begin as of January 1, 1936.

2. X shall ascertain its "average" cost of production, monthly, and shall deliver its entire output to Y, tentatively billing same at cost (X's cost).

3. Y will convert the materials thus acquired from X into a finished product which is to be sold to the public at prevailing market prices.

4. Each company is to consider Administrative expenses as part of the cost of the products manufactured and all selling expenses, sales allowances and bad debts arising from sales for the contract period as reductions of sales income.

5. In addition to the tentative billing price (cost price to X) of X's product, Y is to pay to X as additional purchase price of the materials purchased, 50% of the net profits arising from sales of products made from X's materials after deduction of all expenses applicable thereto. That is to say: The tentative billing price, based on the average cost obtained by X for the whole year, is to be used as tentative cost by Y, and Y will compute its tentative proratable profits on that basis. (The additional payment to X under the contract shall constitute additional sales income to X and additional cost of materials to Y.)

6. Out of each 100 pounds of material consumed in Y's production, there will be produced an average of 90 pounds of finished product, Y's process loss being 10% of materials consumed. The contract provides that Y is to bear the entire process loss. That is to say: If X delivers 100 pounds, at the tentative cost, and Y produces and makes a profit on 90 pounds of product, then X shall be paid on the basis of what the profits would have been had there been no process loss, or as if 100 pounds of Y's product had been sold.

7. Materials purchased from others (similar to those purchased from X) may be used by Y, in which case the tentative net profits of Y are to be allocated to materials purchased from X and materials purchased from others on a tonnage-consumed basis. Y is to retain all profits attributable to sale of products manufactured from materials purchased from others and all profits attributable to the inventory of January 1, 1936, all of which was sold during the year 1936.

You have been called in by the X and Y companies jointly to prepare Manufacturing and Profit and Loss Statements for each company for the year 1936, and a statement showing computation of additional payment to X under the contract. You are to accept as being correct all inventory quantities, prices, and amounts. You are to assume that Y made the same tentative net profit per ton on all goods sold during the year. You are to ignore income tax calculations. Work papers should also be submitted.

You have been handed the following statements, which were prepared from the books as of December 31, 1936.

STATEMENTS OF PROFIT AND LOSS ACCOUNTS—PER THE BOOKS

	X Company		Y Company	
Credits:				
Inventory 12-31-36	25 Tons	$ 625	375 Tons	$ 22,500
Income from rental property		2,850		
Income from securities owned		7,500		
Collection of accounts written off in prior years		1,250		2,500
Sales to Y	33,075 Tons			
Tentative monthly billing		820,675		
Additional under contract		799,812		
Sales to trade			39,393 Tons	3,340,677
Totals (A)		$1,632,712		$3,365,677
Debits:				
Finished goods inventory 1-1-36	100 Tons	$ 3,250	1,000 Tons	$ 52,500
Materials purchased from X			33,075 Tons	
Tentative monthly billing				820,675
Additional under contract				799,812
Materials purchased from others		240,000	10,000 Tons	400,000
Direct labor		420,000		375,000
Factory burden		80,000		60,000
Depreciation—Factory		75,000		60,000
Depreciation—Rental property		1,000		
Repairs to rental property		750		
Allowances—1935 sales		750		1,750
Allowances—1936 sales				2,250
Bad debts—1935 sales		150		750
Bad debts—1936 sales				1,000
Administrative expenses		10,000		7,500
Selling expenses				22,500
Loss on sale of securities		2,000		
Produced in year	33,000 Tons		38,768 Tons	
Totals (B)		$ 832,900		$2,603,737
Profit for year (A) minus (B)		$ 799,812		$ 761,940

AUDITING

NOVEMBER 20, 1936—2 P. M. TO 6 P. M.

Answer All Questions

Do not repeat questions, but designate them by numbers and letters

Question 1:

In the accounts of the B Company you discover an item of unclaimed dividends which has been carried in the accounts-payable ledger in a constantly increasing amount over a period of years. On the balance sheet, the account has always been merged with trade accounts payable. How would you verify the account and what adjustment or other disposition of the item would you make in your annual audit of and report on the company's accounts?

Question 2:

How may an auditor test for raw-material overstock in a manufacturing business where perpetual-inventory records are maintained?

Question 3:

C Company from time to time sells its accounts receivable to a discount corporation, with recourse, 80% of the account being advanced in cash. What balance-sheet notations does this call for? How would you as an auditor determine the unpaid accounts at the balance-sheet date?

Question 4:

You are engaged to make a detailed audit of a corporation's books for the current year. The company had been in business for many years, but the books had never been previously audited. State if you would confine your audit strictly to the current year. Explain fully.

Question 5:

You are engaged to make a monthly audit for a corporation dealing in machinery and mill supplies and to render monthly an income and profit and loss statement and balance sheet. Perpetual inventories are kept by the "Cost of Sales" method (i. e., extending cost of sales in the sales records). Would your procedure be the same for the monthly audits as at the close of the fiscal year? Explain fully. Assuming that at the end of the fiscal year there was a large difference between the perpetual inventory and the physical inventory taken what would be your attitude and how would you treat this difference in your last monthly profit and loss statement and in the annual statement for the year?

Question 6:

In auditing the December 31, 1935, balance sheet of a textile mill, you find that there are large contractual obligations for the purchase and future delivery of raw cotton at prices considerably above the market price at that date.

Draft a letter to the client outlining your reason for wishing to qualify your certificate, if no allusion is to be made in the balance sheet to the foregoing fact, and suggesting alternative methods of statement which would meet with your approval and enable you to append a clear certificate.

Question 7:

During the audit of a manufacturing concern an addition of $50,000.00 is found in the patent account representing, as explained in the journal entry, the value of certain patents, patent rights and processes purchased from the president of the company. The offsetting credit is to capital stock.

(a) What verification for purposes of valuation will be necessary?

(b) How and where will this item be shown on the balance sheet?

(c) Would this item be subject to depreciation? If so, at what rate?

Question 8:

(a) How would you verify dividends and interest received by a large estate?

(b) In verifying notes payable of a company where complete books are not kept, how may you determine whether or not you have accounted for all notes payable outstanding?

Question 9:

(a) What attitude should the auditor adopt toward postdated invoices included in accounts receivable?

(b) Postdated checks from customers totaling $12,500.00 appear as part of the cash on hand of a company you are auditing. These checks were ultimately deposited and collected in full. Would you object to their inclusion as cash?

Question 10:

(a) You are making an audit for a corporation which has bank accounts in various cities and is accustomed to transfer funds from one to the other. How would you verify bank balances as of a given date?

(b) Warehouse receipts are presented to you as evidence of item of "Goods in warehouse in other cities." Would you consider them as sufficient evidence to verify the account?

COMMERCIAL LAW

NOVEMBER 21, 1936—9 A. M. TO 1 P. M.

Give Reasons for All Answers

Designate Questions by Numbers

Question 1:

(a) State the difference between an "Estate Tax" and an "Inheritance Tax."

(b) Which, if either, of the above types of tax is in force under the laws of the State of Virginia, and under the laws of the United States Federal Government?

Question 2:

The name of John Doe, as maker, is forged to a sixty-day negotiable note which is discounted for full value at the X. Y. National Bank. Upon the maturity of the note and demand being made for payment, John Doe claims his signature was forged. What are the rights of John Doe and of the X. Y. National Bank?

Question 3:

John Doe wishes to purchase from the A. B. Department Store merchandise of the value of $50.00 and wishes to have the same charged, giving the name of Richard Roe as reference. A representative of the A. B. Department Store calls on Richard Roe, who speaks well of John Doe and promises verbally that if John Doe does not pay the bill he will do so. The credit is extended, but the bill is not paid when due. What are the rights of the A. B. Department Store against John Doe and Richard Roe?

Question 4:

A, the owner of certain real estate, executed a deed of trust thereon securing 3 notes aggregating $2,500.00 payable three years after date to the order of the X. Y. National Bank. About one year after executing this deed of trust A sold the property covered by said trust to B, who expressly assumed the payment of said deed of trust for $2,500.00 as part of the purchase price. Upon the maturity of the deed of trust debt, B, the then owner of the property, requested an extension of one year from the X. Y. National Bank, which still owned the notes, and agreed to pay interest at the current rate during the extended period. The bank granted the extension and A was not notified. At the expiration of the extension the debt was not paid, and the property was sold under the deed of trust. The property did not bring enough to pay the debt and there was a deficit of $500.00. What are the rights, if any, of the X. Y. National Bank (a) against A (b) against B?

Question 5:

The X. Y. Z. Corporation did business in the States of Virginia and North Carolina, and kept bank accounts in the name of the Corporation in the A. B. National Bank in North Carolina and the C. D. National Bank in Virginia. John Doe was the Vice-President of the Corporation and an official authorized to draw checks. John Doe drew check in the name of the X. Y. Z. Corporation on the A. B. National Bank in North Carolina in the sum of Five Thousand Dollars payable to the order of the C. D. National Bank in Virginia, which check was endorsed "John Doe" and deposited to the individual account of John Doe. The check was paid in due course and John Doe embezzled the proceeds thereof. Is there any liability on the part of the C. D. National Bank to the X. Y. Z. Corporation?

Question 6:

John Doe in 1930 owns a house worth $10,000.00 with no mortgage thereon, stocks and bonds of the value of $50,000.00, and at the same time he owes an open note, without collateral or endorsement, in the sum of $2,000.00 to the A. B. National Bank. In 1931, John Doe executes a deed of gift conveying his home to his wife, Stella Doe, the note to the bank being still unpaid. In 1933, John Doe has severe financial reverses and all of his individual property is lost. Stella Doe however keeps her home. The note to the bank is still unpaid, having been renewed from time to time for the same principal amount. Does the A. B. National Bank have any claim at this time against the home previously deeded to his wife?

Question 7:

Richard Roe, an attorney at law, frequently lends money for his clients secured by deeds of trust on real estate and charges the borrowers a commission of 5% for securing the money. He also has certain money belonging to himself personally, and out of his personal funds he lends John Doe $5,000.00 secured by deed of trust on real estate and charges the usual 5% commission. The loan bears interest at the rate of six per cent per year. Later John Doe learns that this money belonged to Richard Roe personally. What are the rights, if any, of John Doe in this case? Give reasons.

Question 8:

John Doe is married and his wife is named Stella Doe. John Doe has a life insurance policy in the principal sum of $5,000.00 payable to his estate, which policy has a cash surrender value of $749.15 as of June 15, 1936. He also has another policy in the principal sum of $5,000.00 payable to Stella Doe, which policy has a cash surrender value of $538.24 on June 15, 1936. John Doe fails in business and files petition in bankruptcy on the 15th day of June, 1936. What rights, if any, does the trustee in bankruptcy for John Doe have relative to the above two insurance policies?

Question 9:

Richard Roe, aged 19 years, buys a Ford automobile from the X. Y. Motor Company and makes a cash payment of $100.00, executing a note for the balance due payable at the rate of $35.00 per month beginning one month after date. The X. Y. Motor Company retains title to the car under the usual conditional sales contract. After making two monthly payments of $35.00 each, Richard Roe refuses to make further payments. Give in detail the rights of the parties.

Question 10:

At a meeting of the board of directors of a corporation at which five members (a quorum) were present, Director A moved that the corporation enter into a contract with Director B, which contract was very advantageous to B. On vote, Directors A, B, and C voted aye and Directors D and E nay. The chair declared the motion carried and ordered the contract made. Was the contract entered into a valid contract? Give reasons.